# No. 10,243

IN THE

# United States Circuit Court of Appeals

**For the Ninth Circuit**

---

UNITED STATES OF AMERICA,
*Appellant,*

vs.

WESTERN SHORE LUMBER COMPANY
(a corporation),
*Appellee.*

**On Appeal from the District Court of the United States for the Northern District of California.**

## BRIEF FOR APPELLANT.

---


SAMUEL O. CLARK, JR.,
Assistant Attorney General,
SEWALL KEY,
A. F. PRESCOTT,
PAUL S. McMAHON,
Special Assistants to the Attorney General,
FRANK J. HENNESSY,
United States Attorney,
ESTHER B. PHILLIPS,
Assistant United States Attorney,
*Attorneys for Appellant.*

## Subject Index

## Table of Authorities Cited

### Cases



### Statutes



### Miscellaneous

No. 10,243

IN THE

# United States Circuit Court of Appeals

## For the Ninth Circuit

---

UNITED STATES OF AMERICA,
*Appellant,*

vs.

WESTERN SHORE LUMBER COMPANY
(a corporation),
*Appellee.*

**On Appeal from the District Court of the United States for the Northern District of California.**

## BRIEF FOR APPELLANT.

---

### OPINION BELOW.

There has been no previous opinion in this case. The District Court filed findings of fact, conclusions of law and directions for entry of judgment (R. 107-120), which are not reported.

---

### JURISDICTION.

This is an appeal from a judgment entered August 13, 1941, by the District Court, in favor of the appellee for the sum of $2299.00, with interest of $909.52 and costs of $10.00 (R. 121-122). The action arose under the Internal Revenue Laws of the United

States, and is for recovery of capital stock taxes and interest paid for the taxable periods ended each June 30 from 1933 to 1936, inclusive, with legal interest from payment dates. The jurisdiction of the District Court was invoked under the provisions of Section 24, Twentieth, of the Judicial Code, as amended. The case is brought to this Court by notice of appeal filed November 12, 1941 (R. 122). The jurisdiction of this Court is invoked under the provisions of Section 128 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

---

**QUESTION PRESENTED.**

Whether taxpayer corporation was carrying on or doing business during the taxable periods involved within the meaning of the capital stock tax laws.

---

**STATUTES AND REGULATIONS INVOLVED.**

Revenue Act of 1935, c. 829, 49 Stat. 1014:

Sec. 105. CAPITAL STOCK TAX.

(a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1.40 for each $1,000 of the adjusted declared value of its capital stock. [Amended by Section 601 of the Revenue Act of 1936 to make the rate of the tax $1 for each $1,000.)

* * * * * * *

Treasury Regulations 64 (1936 ed.):

Art. 41. *Nature and rate of tax.*—The tax is an excise tax imposed with respect to carrying on or doing business during a taxable year ending June 30, or any fractional part thereof. It is an excise tax upon the exercise of the privilege of doing business and not on the business itself and is imposed upon each corporation with respect to carrying on or doing business and not upon each business carried on. If more than one corporation is engaged in carrying on a single business, each must file a return and pay the tax. * * *

Art. 42. *Doing business.*—The term "business" is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. Similarly, even if not organized for profit, any corporation which nevertheless engages in activities ordinarily carried on for profit is also doing business. It is immaterial whether the activities result in a profit or a loss, whether the corporation has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year.

The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one

in which the corporation is not pursuing the ends for which organized, i.e., profit.

Art. 43. *Illustrations.*—(a) *General.*—In general "doing business" includes any activities of a corporation whether it engages in—

(1) buying, selling, manufacturing, developing, financing, speculating or otherwise dealing in property of any description;

(2) furnishing services of any character;

(3) leasing or managing properties, collecting rents or royalties;

* * * * * * *

(5) the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distributing the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property; or

(6) any other activities coming within the ordinary and natural signification of the term "carrying on or doing business".

(b) *Exceptions.*—Ordinarily the exceptions to "doing business" are restricted to limited activities of a corporation, such as—

(1) the issuance and sale of its stock for cash as a preliminary step in the completion of its organization; or

(2) the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of its corporate status in the case in which the corporation either was

organized for, or has reduced its activities to, the mere owning and holding of specific property.[1]

---

**STATEMENT.**

The facts, as found by the District Court, are substantially as follows (R. 107-117):

Western Shore Lumber Company, the taxpayer, was organized in 1905 as a California corporation. Its purpose was to acquire timber lands in San Mateo and Santa Cruz Counties in California. The organizers believed that a railroad was to build a line through the area but the road was never built and the company never engaged in active lumber operations. (R. 107-108.)

In order to pay taxes and current expenses, the company permitted some timber and tanbark to be cut from its land and from that source obtained $36,449.56 between 1905 through 1910. From a similar source the taxpayer obtained $25,094.63 between 1911 and 1922. (R. 108.)

During 1920 some acreage was sold to the State of California for park purposes at a price of $38,400.

---

[1]The taxes involved in this action are capital stock taxes paid for the taxable periods ended each June 30, 1933 to 1936, and they were collected under the provisions of Section 215 of the National Industrial Recovery Act, c. 90, 48 Stat. 195, for 1933, Section 701 of the Revenue Act of 1934, c. 277, 48 Stat. 680, for 1934 and 1935; and Section 105 of the Revenue Act of 1935, c. 829, 49 Stat. 1014, as amended, for 1936. Each of the taxing statutes and the regulations promulgated thereunder are substantially similar. For that reason extracts from the taxing statute and the regulations under only the 1935 Act are set out above.

During 1918 and 1919 the taxpayer operated a shingle mill but the mill was never operated after 1921. The shingle mill is the only active operation ever carried on by the taxpayer. (R. 108.)

Since the shingle mill was closed the taxpayer's activities have been confined to maintaining and holding its properties until they could be satisfactorily liquidated. The taxpayer paid federal capital stock taxes for the annual periods 1923 through 1926 but filed claims for refund thereof, which were allowed in 1929, on the ground that the company had not engaged in business during those years. (R. 108-109.)

Taxes on the company's properties have been substantial. For a time the taxes were paid out of funds on hand and loans made by stockholders. From 1925 to 1929 assessments were levied against stockholders to pay taxes. In order to provide funds for taxes and current expenses a stumpage contract was entered into with Santa Cruz Lumber Company in 1929, under which that company cut and paid for timber from an isolated portion of the taxpayer's properties. Receipts from the contract have been sufficient to pay taxes and to reduce previously incurred indebtedness to stockholders. The amount of such indebtedness on July 1, 1932, was $66,850.75. (R. 109.)

The period in issue in this action is from July 1, 1932, to June 30, 1936. At the commencement of the period the taxpayer's assets consisted solely of approximately 12,500 acres of timber lands in San Mateo County and 550 acres of timber lands in Santa Cruz County and certain cash in bank accounts. From

July 1, 1932, to June 30, 1936, the taxpayer had no activities except holding and safeguarding the timber properties and occasional negotiations looking toward their disposition as a whole. Little supervision was necessary. The activities carried on by the taxpayer were conducted in the same manner as during the period from 1922 to 1926. During the periods from 1932 through 1936, no meetings of stockholders were held and only three meetings of directors, two during 1933 and one in the 1936 period. At the 1933 directors meetings only routine corporate actions were taken, such as electing officers, employment of auditors, et cetera. The only non-routine corporate action taken at the 1936 meeting was the ratification of a supplemental agreement with Santa Cruz Lumber Company permitting the cutting of timber from certain additional land of the taxpayer under the terms of the existing contract. (R. 109-110.)

Except for the supplemental agreement ratified at the 1936 directors meeting the taxpayer executed no contracts during the period between July 1, 1932, and June 30, 1936. No property except office supplies was purchased. No investments were made. Other than timber no property was sold. The taxpayer's only receipts were interest on bank accounts and the amounts paid under the stumpage contract with Santa Cruz Lumber Company. The taxpayer had no employees except a secretary who was paid $25 per month and a caretaker employed to maintain trails through the timber property and keep a look-out for fires, whose salary was $1800 per year. The tax-

payer's only other disbursements were for taxes, interest on indebtedness, office expenses not in excess of $365 per year, and the amount of $300 per year paid as partial compensation to a man who checked the timber tally made by Santa Cruz Lumber Company under the stumpage contracts. During the taxable periods involved the taxpayer disbursed no dividends nor any other disbursements to its stockholders except payments upon the interest and principal of indebtedness to the stockholders previously incurred. (R. 110-111.)

The taxpayer's timber is mostly redwood. It is the only large holding of redwood timber left in the vicinity and some negotiations have been had toward the sale of the timber to the State for park purposes. The taxpayer has been unwilling to sell the timber or lands piece-meal but has made efforts to sell the properties as a whole and has given options to prospective purchasers on several occasions although no such option was given during the periods from 1932 through 1936. (R. 111-112.)

The taxpayer's directors have given considerable thought as to a means of liquidating the property but could arrive at none except through a sale to the County of San Mateo or the State of California or by a program of logging contracts, which the taxpayer did not care to undertake. Under the stumpage contracts entered into the property is completely deforested and rendered almost valueless. The contracts with Santa Cruz Lumber Company covered 1500 or 1600 acres, which are in an isolated section, and their

deforestation does not affect the value of the remaining properties as a park site. The area which has been cut over, in the opinion of the president of the company, is worth only fifty cents an acre after deforestation. (R. 112.)

The receipt of income under the stumpage contracts constitutes the only difference between the activities of the taxpayer during the periods here involved and its activities during the period from 1922 through 1926, when the taxpayer was held not to have engaged in business for federal capital stock tax purposes. (R. 112-113.)

The timber stumpage contracts were made to obtain funds to pay taxes and current expenses. The first contract was executed on April 23, 1929, and related to 480 acres of land. Santa Cruz Lumber Company was given the right to remove from the land all redwood timber, pine timber and tanbark. It agreed to pay $4 per thousand feet, board measure, for redwood and pine and $5 per cord for tanbark, with a minimum guaranteed payment of $10,000. The board measure of the timber cut was made by a tally at the tail end of the mill of the operating company. The tally was made by a man selected by the parties, whose expenses were borne equally by the parties. The operating company was required to proceed continuously with the removal of timber and tanbark and the taxpayer had the right to inspect the operations of Santa Cruz Lumber Company and its books and records for the purpose of ascertaining that all provisions of the contract were complied with. The first

contract was to expire in two years. A second contract was entered into by the same parties on March 10, 1930 and contained terms similar to those in the first contract. The second contract was to run for a period of eight years. A third contract was entered into on January 17, 1936 by the same parties, relating to the same 480 acres covered by the first contract, and provided that such acreage should be deemed to be covered by the contract of March 10, 1930. (R. 113-114.)

The taxpayer's activities in connection with the timber stumpage contracts were limited to the receipt of money thereunder, except that it paid the tally man $300 per annum to verify the tally made by the operating company upon the basis of which payments were made. Payments for timber and tanbark were required to be made monthly and the taxpayer received on that account the following sums: (R. 114.):

| Year ending June 30 | Amount received |
|---|---|
| 1933 | $21,206.70 |
| 1934 | 32,372.78 |
| 1935 | 4,625.93 |
| 1936 | 9,404.54 |

After payment of taxes, current expenses and interest, and after setting aside a reserve for taxes, the balance of the moneys received were used toward retirement of the indebtedness to stockholders. During the taxable periods involved in this action $13,821.89 was paid on the indebtedness and subsequently the whole indebtedness was paid off out of timber stumpage receipts. (R. 115.)

For income tax purposes the taxpayer had a profit during the taxable periods involved aggregating $10,007.86, but its total deficit at December 31, 1936 was $165,846.69. (R. 115.)

The taxpayer engaged in no operations under the stumpage contracts. The contracts were in substance a license to an operating company to cut timber from an isolated tract of the taxpayer's properties and to pay for the timber as cut. The cut-over land was rendered substantially valueless and the operation amounted in essence to a liquidation of the property from which the timber was cut. (R. 115.)

With the exception of the supplemental agreement dated January 17, 1936, the stumpage contracts were not negotiated during the taxable periods involved in this action. (R. 115.)

The taxpayer filed timely capital stock tax returns for each of the taxable periods 1933 to 1936, inclusive, and paid the amounts of taxes indicated thereon. Timely claims for refund were filed for each of the payments made for the periods mentioned, on the ground that the corporation had not engaged in business and was not liable for the capital stock tax during any of the periods. (R. 116.)

The Commissioner of Internal Revenue rejected each of the claims for refund and notified the taxpayer of his action by letter dated January 26, 1938. This action was then timely commenced by filing the complaint herein on November 30, 1939. The action is based on the same grounds as set forth in the claims for refund. (R. 116-117.)

Upon the basis of the foregoing findings of fact, the Court below concluded as matters of law that (R. 117-118):

The taxpayer has reduced its activities to ownership and holding of property, the distribution of its avails, and doing only necessary acts to maintain its corporate existence and the management of its internal affairs and is not doing business within the meaning of the capital stock tax laws. (R. 117.)

The liability for the capital stock tax must be determined by the purpose for which the corporate organization was maintained and where, as in the present case, there was no intent during the taxable period and for many years prior thereto to carry on any active enterprise and the sole purpose of the corporation was to hold its timber lands and effect a sale of the whole as soon as a fair price could be obtained, the proceeds to be distributed to stockholders, and there was no purpose or activity which constituted efforts or the use of capital in the pursuit of gain and profit; the taxpayer was not doing business. (R. 117-118.)

The taxes involved were erroneously and illegally collected and the taxpayer is entitled to a refund thereof with legal interest. (R. 118.)

---

**STATEMENT OF POINTS TO BE URGED.**

The government relies on all the points specified. (R. 227-229.) In substance they are that the judgment of the District Court is contrary to law; that the

judgment is contrary to the facts found by the Court and that the facts found do not support the conclusions of law rendered by the Court.

---

## SUMMARY OF ARGUMENT.

Any doubts that the taxpayer was doing business so as to be liable for the capital stock tax have been resolved by the Supreme Court decision in *Magruder v. Washington, B. & A. Realty Corp.* In that case a corporation organized to liquidate properties, and doing so, was held to be doing business as falling within the provisions of the regulations of long standing. The regulation was held to be valid as well as applicable. The same regulation is applicable here.

This taxpayer's activities were directed toward liquidating its properties as satisfactory offers were obtained, as were the activities of the taxpayer in the Supreme Court case. Differences in the purposes for organization of the corporations are not controlling where the activities are of a business nature. The extent of the activities is not material if any business is carried on. Performing engagements entered into in a prior year is nonetheless doing business during the taxable year.

## ARGUMENT.

### THE TAXPAYER WAS DOING BUSINESS DURING THE TAXABLE PERIODS INVOLVED AND IS SUBJECT TO THE CAPITAL STOCK TAX.

Doubts as to whether this taxpayer's activities during the taxable periods involved constitute doing business within the meaning of the capital stock tax laws would seem to have been resolved in favor of the government by the recent decision in the case of *Magruder v. Washington B. & A. Realty Corp.*, 316 U. S. 69, decided April 13, 1942. In that case a corporation was organized for the purpose of liquidating the properties of another corporation, and since its organization carried on negotiations for the sale of properties, selling them from time to time as satisfactory offers were received, and renting unsold properties under short term leases in an attempt to earn the carrying charges pending ultimate sales of all of the properties. The corporation was held to be doing business for the purpose of the tax. The case turned upon the question whether Article 43 (a) (5) of Treasury Regulations 64 (1936 ed.) was both applicable and valid. The Article mentioned is also one of the articles of the regulations upon which the government relies in the present case. The Supreme Court held at pages 72-74:

> The regulation, Article 43 (a) (5), provides:
>
> "Art. 43. *Illustrations.—General.*—In general 'doing business' includes any activities of a corporation whether engaged in——
>
> * * * * * *
>
> "(5) the orderly liquidation of property by negotiating sales from time to time as opportunity

and judgment dictate and distributing the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property;"

If the regulation is both applicable and valid, respondent manifestly cannot prevail.

On the question of applicability there can be no doubt, for the language of the regulation precisely describes respondent's activities. We find without substance respondent's assertions that Article 43 (b) (2) is inconsistent with Article 43 (a) (5) and that it more exactly fits the facts of this case. During the period in question, respondent did not fall into that state of quietude, covered by the specific language of Article 43 (b) (2), in which it was merely owning and holding specific property and distributing the resulting proceeds. See *Zonne v. Minneapolis Syndicate,* 220 U. S. 187; cf. *Von Baumbach v. Sargent Land Co.,* 242 U. S. 503, 516-17. On the contrary, respondent was actively engaged in fulfilling the purpose of its creation, the liquidation of its holdings for the best obtainable price.

Article 43 (a) (5) is both a contemporary and a long standing administrative interpretation, having been in effect in substantially the same form since 1918, except for the period from 1926 to 1933 when the tax was not imposed. We are of opinion that it is valid, as well as applicable. The crucial words of the statute, "carrying on or doing business," are not so easy of application to varying facts that they leave no room for administrative interpretation or elucidation. To be sure, in many, if not in most instances, the factual situ-

> ation will be so extreme as to leave no doubt whether a corporation is doing business or not. But the nuances of facts between the two extremes have produced a nebulous field of confusion which has been recognized by courts striving to fit close cases into one category or the other. Interpretative regulations, such as Article 43(a)(5), are appropriate aids toward eliminating that confusion and uncertainty. Cf. *Helvering v. Wilshire Oil Co.,* 308 U. S. 90, 102; *Textile Mills Securities Corp. v. Commissioner,* 314 U. S. 326.

Factually the present case is not on all-fours with the *Washington B. & A. Corp.* case, *supra,* but the differences, we believe, are not such as to cause a contrary decision of the ultimate question. The corporation involved in the Supreme Court case was organized to liquidate properties, whereas the present taxpayer was organized as a logging and lumber company but during the taxable periods had reduced its activities to efforts looking toward liquidating all of the corporation's properties when satisfactory offers were obtained. We find no indication in the Supreme Court decision that corporations carrying on activities looking toward liquidation should be distinguished, so as to hold one organized for the purpose of liquidating properties to be doing business and another organized originally as an operating company not to be doing business. In either event the *activities* are similar and we submit that if such activities constitute doing business in one case they do in both cases. In the present case there can be no question but that the activities of the corporation were directed toward liquidating its properties. The District Court correctly

and specifically so found. (R. 109, 112, 115.) The District Court said (R. 115):

> * * * The land from which the timber was cut was rendered substantially valueless and the operation amounted in essence to a liquidation of the property from which the timber was cut.

If there were doubt or conflict in the decisions at that time the subsequent decision of the Supreme Court, we submit, requires the holding that the acts of liquidating and the activities of the taxpayer in connection therewith constituted doing business.

It may be urged that the *Washington, B. & A. Realty Corp.* carried on a more concerted or more continuous program of liquidation than this taxpayer did or that the activities were more closely confined to the taxable periods involved. However, neither consideration should make the cases distinguishable. If it be the fact that the *Washington, B. & A. Realty Corp.* was more active than the present taxpayer it is only a matter of degree and it has been frequently held that the statute "requires no particular amount of business in order to bring a company within its terms." *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503, 517; *Page v. M. Rich & Bros. Co.*, 99 F. 2d, 607; *Argonaut Consolidated Mining Co. v. Anderson*, 52 F. 2d 55 (C. C. A. 2), certiorari denied, 284 U. S. 682; *American Investment Securities Co. v. United States*, 112 F. 2d 231 (C. C. A. 1). In the cases cited the quantity of business carried on by the corporations involved was not substantial, and was fairly comparable to the activities of the taxpayer

here. Thus, in the *Von Baumbach* case the corporation had leased its mineral lands on a royalty basis, received the rentals, employed another company to inspect the properties for it, and sold and rented certain minor portions of its other real estate. It would seem that if leasing ore lands on a royalty basis, with the right of inspection reserved as in the *Sargent Land Co.* case, *supra,* is doing business, then selling timber stumpage, with the right of inspection and checking reserved as in this case, must also be doing business.

The fact that two of the taxpayer's stumpage contracts were entered into prior to the taxable periods and only one contract ratified within a taxable period is not important. In the recent case of *Barker Bros. Corporation v. Rogan,* 126 F. 2d 917 (C. C. A. 9th) this Court referred to the well established principle that the fact that transactions by the taxpayer during the taxable period performed engagements made in a prior year made the performance none the less business done in the taxable year. The operations under the stumpage contracts were continuous throughout the taxable periods and subsequently. Receipts from the contracts were substantial ranging from $4625.93 in 1935 to $32,372.78 in 1934 (R. 114), and in later years an indebtedness of $165,846.69 was paid out of timber receipts. (R. 115.)

Viewed as a whole, it is submitted that the taxpayer's situation and activities constituted doing business within the meaning of the applicable statutes and regulations and the controlling authorities.

## CONCLUSION.

The decision of the District Court is in error and should be reversed.

Dated, November 13, 1942.

Respectfully submitted,

SAMUEL O. CLARK, JR.,
Assistant Attorney General,
SEWALL KEY,
A. F. PRESCOTT,
PAUL S. MCMAHON,
Special Assistants to the Attorney General,
FRANK J. HENNESSY,
United States Attorney,
ESTHER B. PHILLIPS,
Assistant United States Attorney,
*Attorneys for Appellant.*